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DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 96-0164
Income Tax
For Tax Years 1989, 1991 and 1992

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ISSUES

I. Income Tax—Sale of consignment inventory

Authority: Reynolds Metals Company v. Indiana Department of State Revenue, 433 N.E.2d 1 (Ind. App. 1982); IC 6-2.1-3-3; 45 IAC 1-1-47; 45 IAC 1-1-49

Taxpayer protests assessment of income tax on inventory it stored at customer's factory on a consignment basis.

II. Tax Administration—Negligence Penalty

Authority: IC 6-8.1-10-2.1; 45 IAC 15-11-1; 45 IAC 15-11-2

Taxpayer protests imposition of a 10% negligence penalty.

STATEMENT OF FACTS

Taxpayer manufactured parts in Tennessee and maintained an inventory at its customer's plant in Indiana. The parts were incorporated into customer's products as needed, and paid for as used. The auditor assessed income tax on the parts sold. Taxpayer asserts that the sales constituted interstate commerce and were therefore exempt from Indiana taxes. More information will be provided as necessary.

I. Income Tax—Sale of consignment inventory

DISCUSSION

Taxpayer protests imposition of income tax based on inventory it stored at its customer's Indiana facility until the goods were bought and incorporated into the customer's product.

Taxpayer claims that the sales were interstate sales, and were therefore exempt from Indiana income tax, under IC 6-2.1-3-3. IC 6-2.1-3-3 states:

> Gross income derived from business conducted in commerce between the state of Indiana and either another state or a foreign country is exempt from gross income tax to the extent the state of Indiana is prohibited from taxing that gross income by the United States Constitution.

Taxpayer relies on Reynolds Metals Company v. Indiana Department of State Revenue, Gross Income Tax Division, 433 N.E.2d 1 (Ind. App. 1982), to support its claim for exemption. Taxpayer explains that the court in that case held that, "Examination of the agreements here discloses nothing more than a sale with a retained security interest." Taxpayer also cites this paragraph from Reynolds:

> We therefore conclude that the income derived by the house accounts here at issue should be exempt. The mere maintenance of a security interest in goods located within the state is not sufficient nexus with the state to justify the imposition of tax upon the secured party when the goods are ultimately sold by the consignee-distributor.

Id. at 18.

It is worth noting other words the court used to explain why it granted an exemption to Reynolds in that case:

> The products were shipped, upon order, for a stated price, warehoused in consignee's warehouse, (not Reynolds'), and insured by the consignee who paid the property tax, and the consignee was given power under the contract and the UCC to defeat Reynolds' title by sale to any person it desired in the normal course of business in its own name, at a price suitable to the consignee.

Id.

In that case, the goods had been shipped according to an order, for a stated price, and the consignee had the power to defeat Reynolds title by selling to a third party for a price determined by the consignee.

In this case, the taxpayer has provided no evidence that it had that kind of relationship with its customer. Here, the goods were already stored in Indiana before the customer ordered them, took them out of taxpayer's inventory, and paid for them. As taxpayer explained, the goods were never resold and the customer was not acting as taxpayer's agent. Unlike in Reynolds, there was more than a mere maintenance of a security interest in the goods on the taxpayer's part.

Taxpayer, in its protest of this assessment, raises the point that the Reynolds court stated that it believed that the substance of a transaction should be given effect over its form.

Here, the substance of the transaction was that the taxpayer maintained an inventory in Indiana and then sold those goods to an Indiana customer.

Taxpayer also claims that it is inequitable to impose taxes on both companies (taxpayer and its customer) for the same inventory, since both taxpayer and its customer file Indiana returns. 45 IAC 1-1-47 states:

> It must be emphasized that IC 6-2-1-1(m) [repealed by P.L. 77-1981, SECTION 22.] does not relieve a consignor from liability for gross income tax, but states merely that the tax will be paid by the consignee. Thus a consignor is fully taxable on gross receipts derived from the sale of goods in the hands of a consignee in Indiana. The goods constitute the consignor's inventory in the state. When a consignment sale takes place, title passes from consignor to consignee and thence from consignee to buyer, making the sale an Indiana sale with regard to the consignor and consignee, the proceeds from which are subject to gross income tax.

Taxpayer has offered no documentation to show that both companies are being taxed on the same inventory. Even if that were the case, the statute clearly states that taxpayer (consignor) is liable for income from the sale of its goods in Indiana.

Taxpayer states that it does not have a business situs in Indiana. 45 IAC 1-1-49 establishes that a taxpayer may establish a business situs through, "Maintenance of an inventory or stocks of goods for sale, distribution, or manufacture." In this case, taxpayer maintained an inventory of goods for sale. Taxpayer had a business situs in Indiana.

FINDING

Taxpayer's protest is denied.

II. Tax Administration—Negligence Penalty

The taxpayer protests the Department's imposition of the ten percent (10%) penalty assessment. IC 6-8.1-10-2.1 requires a ten percent (10%) penalty to be imposed if the tax deficiency is due to the negligence of the taxpayer. Department regulation 45 IAC 15-11-2 provides guidance in determining if the taxpayer was negligent in nature.

Departmental regulation 45 IAC 15-11-1(b) defines negligence as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." Negligence is also to be determined on a case-by-case basis according to the facts and circumstances of each taxpayer.

Subsection (d) of IC 6-8.1-10-2.1 allows the penalty to be waived upon a showing that the failure to pay the deficiency was due to reasonable cause. Departmental regulation 45 IAC 15-11-2(c) requires that in order to establish reasonable cause, the taxpayer must show that it "exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed. . . ."

In this instance, the taxpayer has provided to the Department's satisfaction, sufficient justification for interpreting the code as it did.

FINDING

The Taxpayer's protest is sustained.

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